Aberdeen City Council Transport Fund (ACCTF)
2014 Funding Strategy Statement (FSS)

This Statement has been prepared by Aberdeen City Council (the Administering Authority) to set out the funding strategy for the Aberdeen City Council Transport Fund (the ACCTF), in accordance with Regulation 31 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 (as amended) and the guidance paper issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) Pensions Panel.

1. INTRODUCTION

The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 (as amended) ("the Administration Regulations") provide the statutory framework from which the Administering Authority is required to prepare a FSS. The key requirements for preparing the FSS can be summarised as follows:

- After consultation with all relevant interested parties involved with the Fund, the Administering Authority will prepare and publish their funding strategy.
- In preparing the FSS, the Administering Authority must have regard to :-
    - the guidance issued by CIPFA for this purpose; and
    - the Statement of Investment Principles (SIP) for the ACCTF published under Regulation 12 of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010;
- The FSS must be revised and published whenever there is a material change in either the policy on the matters set out in the FSS or the Statement of Investment Principles.

Benefits payable under the ACCTF are guaranteed by statute and thereby the pensions promise is secure. The FSS addresses the issue of managing the need to fund those benefits over the long term, whilst at the same time, facilitating scrutiny and accountability through improved transparency and disclosure.

The Scheme is a defined benefit arrangement with principally final salary related benefits from contributing members up to 1 April 2015 and Career Averaged Revalued Earnings ("CARE") benefits earned thereafter. There is also the introduction of a "50:50 Scheme Option", where members can elect to accrue 50% of the full scheme benefits and pay 50% of the normal member contribution.

The benefits provided by the ACCTF are specified in the governing legislation (the Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008 (as amended) ("the BMC Regulations") and the Administration Regulations referred to above. New legislation contained in the Local Government Pension Scheme (Scotland) Regulations 2014 ("the 2014 Regulations") and the Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014 governs the ACCTF from 1 April 2015. The required levels of employee contributions from 1 April 2015 are also specified in the 2014 Regulations.

Employer contributions are determined in accordance with the Administration Regulations which require that an actuarial valuation is completed every three years by the actuary, including a rates and adjustments certificate. Contributions to the ACCTF should be set so as to "secure its solvency", whilst the actuary must also have regard to the desirability of maintaining as nearly constant a rate of Common Contribution as possible. The actuary must have regard to the FSS in carrying out the valuation.

2. PURPOSE OF THE FSS IN POLICY TERMS

Funding is the making of advance provision to meet the cost of accruing benefit promises. Decisions taken regarding the approach to funding will therefore determine the rate or pace at which this advance provision is made. Although the Regulations specify the fundamental principles on which funding contributions should be assessed, implementation of the funding strategy is the responsibility of the Administering Authority.

The purpose of this Funding Strategy Statement is:

- to establish a clear and transparent fund-specific strategy which will identify how the Scheme employer's pension liabilities are best met going forward;
- to support the regulatory requirement to maintain as nearly constant employer contribution rates as possible; and
- to take a prudent longer-term view of funding those liabilities.

3. AIMS AND PURPOSE OF THE ACCTF

The aims of the Fund are to:

- enable the employer common contribution rate to be kept as nearly constant as possible and at reasonable cost to the employer
- manage the employer's liabilities effectively
- ensure that sufficient resources are available to meet all liabilities as they fall due, and
- maximise the returns from investments within reasonable risk parameters.

The purpose of the Fund is to:

- receive monies in respect of contributions, transfer values and investment income, and
- pay out monies in respect of scheme benefits, transfer values, costs, charges and expenses

as defined in the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 (as amended), the Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008 (as amended), the 2014 Regulations and in the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010.

4. RESPONSIBILITIES OF THE KEY PARTIES

The Administering Authority should:

- collect employer and employee contributions
- invest surplus monies in accordance with the Regulations
- ensure that cash is available to meet liabilities as and when they fall due

- manage the valuation process in consultation with the ACCTF's actuary
- prepare and maintain an FSS and a SIP, both after due consultation with interested parties, and
- monitor all aspects of the ACCTF's performance and funding and amend FSS/SIP.

The Scheme employer should:

- deduct contributions from employees' pay correctly after determining the appropriate employee contribution rate (in accordance with the Regulations)
- pay all contributions, including their own as determined by the actuary, promptly by the due date
- exercise discretions within the regulatory framework
- make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain, and
- notify the Administering Authority promptly of all changes to membership or, as may be proposed, which affect future funding.

The Fund actuary should:

- advise on funding strategy, the preparation of the FSS, and the inter-relationship between the FSS and the investment strategyprepare valuations including the setting of employers' contribution rates after agreeing assumptions with the Administering Authority and having regard to the FSS
- prepare advice and calculations in connection with bulk transfers and individual benefit-related matters,
- prepare advice and valuations on the termination of admission agreements
- provide advice to the administering authority on bonds or other forms of security against the financial effect for the fund of employer default
- assist the administering authority in assessing whether employer contributions need to be revised between valuations as required by regulations
- ensure that the administering authority is aware of any professional guidance or other professional requirements which may be of relevance to his or her role in advising the Fund

5. SOLVENCY ISSUES AND TARGET FUNDING LEVELS

Ongoing Funding Objective

To meet the requirements of the Administration Regulations the Administering Authority's long term funding objective is for the Fund to achieve and then maintain sufficient assets to cover 100% of projected accrued liabilities (the "**ongoing funding target**") assessed on an ongoing past service basis including allowance for projected final pay. In the long term, the employer rate would ultimately revert to the Future Service Contribution Rate.

De-risking Funding Objective

The Administering Authority and the Employer have agreed a de-risking or "flightpath" strategy for the Fund. This includes reducing interest and inflation risk exposure. The aim of the flightpath is to "lock in" improvements in funding by switching from growth to defensive or matching *assets. The de-risking plan is to be reviewed annually and is structured to keep contributions as stable as possible, i.e. as the asset allocation is only changed following an improvement in funding, the Employer contributions (and hence recovery plan) are unaffected.*

The de-risking strategy has not yet been implemented and will be allowed for as part of the 2017 actuarial valuation and/or at an earlier review of this statement.

Determination of the Ongoing Funding Target and Recovery Period

The principal method and assumptions to be used in the calculation of the funding target are set out in Appendix 1.

Underlying these assumptions are the following three tenets:

- that the Scheme is expected to continue for the foreseeable future over the run off of the liabilities for the current and former members; and
- favourable investment performance can play a valuable role in achieving adequate funding over the longer term.
- The contributions reflect The Scheme employer's financial strength

The Administering Authority, following consultation with The Scheme employer, has adopted the following objectives for setting the employer contribution rates arising from the 2014 actuarial valuation:

- In the current circumstances, as a general rule, the Fund does not believe it appropriate for deficit contribution reductions to apply compared to the 2011 funding plan where substantial deficits remain.
- The employer contributions will be expressed and certified as two separate elements:
  - a percentage of pensionable payroll in respect of the future accrual of benefit
  - a schedule of lump sum amounts over 2015/18 in respect of the past service deficit subject to review annually (on an upward only basis) based on affordability and from April 2018 based on the results of the 2017 actuarial valuation.

In determining the above objectives the Administering Authority has had regard to:

- relevant guidance issued by the CIPFA Pensions Panel
- the need to balance a desire to attain the target as soon as possible against the short-term cash requirements which a shorter period would impose
- the termination funding objective, and
- the Administering Authority's views on the strength of The Scheme employer's covenant in achieving the objective.

Deficit Recovery Plan

If the assets of the scheme are less than the funding target at the effective date of any actuarial valuation, a recovery plan will be put in place, which requires additional contributions from the employer to meet the shortfall.

Additional contributions will be expressed as annual monetary lump sums, subject to review based on the results of each actuarial valuation.

In determining the actual recovery period to apply, the Administering Authority may take into account some or all of the following factors:

- the size of the funding shortfall;
- the business plans of The Scheme employer
- the assessment of the financial covenant of The Scheme employer; and the security of future income streams
- any contingent security available to the Fund or offered by The Scheme employer such as parent company guarantee, charge over assets, etc.
- the closed nature of the Fund and the expected average future working lifetime of the active membership.
- Any flexibility in light of reductions in the risk profile and funding position over the recovery period.

The assumptions used for assessing the deficit recovery contributions are also set out in Appendix 1.

The Normal Cost of the Scheme (Future Service Contribution Rate)
In addition to any contributions required to rectify a shortfall of assets below the funding target, contributions will be required to meet the cost of future accrual of benefits for members after the valuation date (the "normal cost"). The method and assumptions for assessing these contributions are also set out in Appendix 1.

6. LINK TO INVESTMENT POLICY SET OUT IN THE STATEMENT OF INVESTMENT PRINCIPLES (See Appendix 2)

The results of the 2014 valuation show the liabilities at 31 March 2014 to be 93% covered by the current assets, with the funding deficit of 7% being covered by future deficit contributions.

In assessing the value of the ACCTF's liabilities in the valuation, allowance has been made for asset out-performance as described in Appendix 1, taking into account the investment strategy adopted by the ACCTF, as set out in the SIP, and the future de-risking plans for the Fund.

It is not possible to construct a portfolio of investments which produces a stream of income exactly matching the expected liability outgo. However, it is possible to construct a portfolio which closely matches the liabilities and represents the least risk investment position. Such a portfolio would consist of a mixture of long-term index-linked and fixed interest gilts. Investment of the ACCTF's assets in line with the least risk portfolio would minimise fluctuations in the ACCTF's ongoing funding level between successive actuarial valuations. This least risk target will form part of the development of the de-risking flightpath implemented.

Departure from a least risk investment strategy, in particular to include equity type investments, gives the prospect that out-performance by the assets will, over time, reduce the contribution requirements. The funding target might in practice therefore be achieved by a range of combinations of funding plan, investment strategy and investment performance.

The current benchmark investment strategy, as set out in the SIP, is:

Asset Class (Summary)		%
	Equities	60
	Bonds	40
	TOTAL	**100**

The funding strategy adopted for the 2014 valuation is based on an assumed asset out-performance of 0.25% per annum pre and post-retirement to reflect the longer term termination objectives.

7. IDENTIFICATION OF RISKS AND COUNTER MEASURES

The funding of defined benefits is by its nature uncertain. Funding of the ACCTF is based on both financial and demographic assumptions. These assumptions are specified in the Appendix and the actuarial valuation report. When actual experience is not in line with the assumptions adopted a surplus or shortfall will emerge at the next actuarial assessment and will require a subsequent contribution adjustment to bring the funding back into line with the target.

The Administering Authority has been advised by the actuary that the greatest risk to the ACCTF's funding is the investment risk inherent in the predominantly equity (or return seeking) based strategy, so that actual asset out-performance between successive valuations could diverge significantly from the overall out performance assumed in the long term.

What are the Risks?

Financial

- Investment markets fail to perform in line with expectations
- Market yields move at variance with assumptions
- Investment Fund Managers fail to achieve performance targets over the longer term
- Pay and price inflation significantly more or less than anticipated
- Effect of possible increase in employer's contribution rate on service delivery
- A material reduction in Employer Covenant

In the context of managing various aspects of the Fund's risks, the Administering Authority has embarked on a "Flightpath" risk management investment strategy.

The principle aim of this risk management strategy is to effectively control and limit interest and inflation risks being run by the Fund (as these factors can lead to significant changes to liability values). The overall funding flightpath strategy is to consider and structure the investment strategy to determine a balance between return-seeking and risk-hedging assets. This approach will continue to be developed over the coming months and further details will be included in the Fund's Statement of Investment Principles (SIP).

Demographic

- Longevity horizon continues to expand
- Deteriorating pattern of early retirements (including those granted on the grounds of ill health)
- The last active ceases membership triggering a termination event.

Regulatory

- Further changes to Regulations, e.g. more favourable benefits package, potential new entrants to scheme, e.g. part-time employees
- Changes to national pension requirements and/or HMRC rules

Governance

- Administering Authority unaware of structural changes in The Scheme employer's membership (e.g. large fall in employee numbers, large number of retirements) including the last active member leaving and the triggering of a termination event.
- A deterioration in the Employer's covenant.
- Inadequate inappropriate or incomplete investment and actuarial advice is taken and acted upon

8. MONITORING AND REVIEW

The Administering Authority has taken advice from the actuary in preparing this Statement, and has also consulted with The Scheme employer.

A full review of this Statement will occur no less frequently than every three years, to coincide with completion of a full actuarial valuation. Any review will take account of then current economic conditions and will also reflect any legislative changes.

The Employer's covenant will be reviewed at least triennially with an annual high level review of key trading information.

The Administering Authority will monitor the progress of the funding strategy between full actuarial valuations. If considered appropriate, the funding strategy will be reviewed (other than as part of the triennial valuation process), for example:

- if there has been a significant change in market conditions, and/or deviation in the progress of the funding strategy including the breach of any triggers
- if there have been significant changes to the ACCTF membership, or LGPS benefits
- If the employer covenant deteriorates to an unacceptable level
- if there have been changes to the circumstances of The Scheme employer to such an extent that they impact on or warrant a change in the funding strategy including the reduction in active membership which will be monitored at least quarterly
- if there have been any significant special contributions paid into the ACCTF

Steven Whyte
Head of Finance
Aberdeen City Council as Administering Authority for the Aberdeen City Council Transport Fund

APPENDIX 1

ACTUARIAL VALUATION AS AT 31 MARCH 2014

Method and assumptions used in calculating the funding target, the cost of future accrual and calculating contributions payable under the recovery plan

Method

The actuarial method to be used in the calculation of the funding target is the Attained Age method, under which the salary increases assumed for each member are projected until that member is assumed to leave active service by death, retirement or withdrawal from service. This method makes advance allowance for the anticipated future ageing and decline of the current closed membership group.

Financial assumptions

Investment return (discount rate)

A yield based on market returns on UK Government gilt stocks and other instruments which reflects a market consistent discount rate for the profile and duration of the Scheme's accrued liabilities, plus an Asset Out-performance Assumption ("AOA") 0.25% per annum pre and post-retirement.

The asset out-performance assumptions represent the allowance made, in calculating the funding target, for the long term additional investment performance on the assets of the Fund relative to the yields available on long dated gilt stocks as at the valuation date.

Inflation (Consumer Prices Index)

The inflation assumption will be taken to be the investment market's expectation for RPI inflation as indicated by the difference between yields derived from market instruments, principally conventional and index-linked UK Government gilts as at the valuation date, reflecting the profile and duration of the Scheme's accrued liabilities, but subject to an adjustment due to retirement pensions being increased annually by the change in the Consumer Price Index rather than the Retail Price Index. The reduction to market implied RPI inflation at the valuation date is 0.5% per annum.

Salary increases

The assumption for real salary increases (salary increases in excess of price inflation) over the long term will be determined by an allowance of 2.0% p.a. over the inflation assumption as described above. This includes allowance for promotional increases. In the short term, allowance has been made for expected pay restraint as factored in to The Scheme employer's financial plan. This results in a salary increase assumption equal to CPI inflation for 4 years from the valuation date, reverting to the long term assumption after this period.

Pension increases/Indexation of CARE benefits

Increases to pensions are assumed to be in line with the inflation (CPI) assumption described above. This is modified appropriately to reflect any benefits which are not fully indexed in line with the RPI (e.g. Guaranteed Minimum Pensions in respect of service prior to April 1997).

Demographic assumptions

Mortality

The mortality in retirement assumptions will be based on the most up-to-date information in relation to self-administered pension schemes published by the Continuous Mortality Investigation (CMI), making allowance for future improvements in longevity and the experience of the scheme. The mortality tables used are set out below, with a loading reflecting ACCTF specific experience. The derivation of the mortality assumption is set out in a separate paper as supplied by the Actuary. Current members who retire on the grounds of ill health are assumed to exhibit average mortality equivalent to that for a good health retiree at an age 4 years older whereas for existing ill health retirees we assume this is at an age 3 years older. For all members, it is assumed that the accelerated trend in longevity seen in recent years will continue in the longer term and as such, the assumptions build in a minimum level of longevity 'improvement' year on year in the future in line with the CMI projections subject to a minimum rate of improvement of 1.5% per annum.

The mortality before retirement has also been adjusted based on LGPS wide experience.

Commutation

It has been assumed that, on average, 50% of retiring members will take the maximum tax-free cash available at retirement and 50% will take the standard 3/80ths cash sum. The option which members have to commute part of their pension at retirement in return for a lump sum is a rate of £12 cash for each £1 p.a. of pension given up.

Other Demographics

Following an analysis of Fund experience carried out by the Actuary, the incidence of retirement in ill health and death before retirement have been modified from the last valuation. Other assumptions are as per the last valuation.

Expenses

Expenses are met out the Fund, in accordance with the Regulations. This is allowed for by adding 2.7% of pensionable pay to the contributions as required from The Scheme employer. This addition is reassessed at each valuation. Investment expenses have been allowed for implicitly in determining the discount rates.

Discretionary Benefits

The costs of any discretion exercised by an employer in order to enhance benefits for a member through the Fund will be subject to additional contributions from the employer as required by the Regulations as and when the event occurs. As a result, no allowance for such discretionary benefits has been made in the valuation

Summary of key whole Fund assumptions used for calculating funding target and cost of future accrual (the "normal cost") for the 2014 actuarial valuation

Long-term gilt yields	
Fixed interest	3.5% p.a.
Index linked	-0.1% p.a.
Past service Funding Target and Future service accrual financial assumptions	
Investment return/Discount Rate	3.65% p.a.
CPI price inflation	3.1% p.a.
Long Term Salary increases	5.1% p.a.
Short Term Salary increases (4 years)	3.1% p.a.
Pension increases/indexation of CARE benefits	3.1% p.a.

Demographic assumptions

The post retirement mortality tables adopted for this valuation are as follows:

Life expectancy at 65 in 2013		Base table	Adjustment	Improvement model	Long term rate
CURRENT ANNUITANTS	Normal health	S1PxA	103% / 107%	CMI_2013	1.5%
	Ill health	S1PxA	Normal health + 3 years	CMI_2013	1.5%
	Dependants	S1PMA/S1DFA	228% / 120%	CMI_2013	1.5%
CURRENT ACTIVES / DEFERREDS	Actives normal health	S1PMA	106% / 103%	CMI_2013	1.5%
	Actives ill health	S1PMA	Normal health + 4 years	CMI_2013	1.5%
	Deferreds	S1PMA	127% / 91%	CMI_2013	1.5%
	Future dependants	S1PMA/S1DFA	100% / 105%	CMI_2013	1.5%

Other demographic assumptions are noted below:

Retirement in normal health	As for 2011 valuation
Withdrawal	As for 2011 valuation
Proportions married	As for 2011 valuation
Other demographics	Based on LG scheme specific experience.
50:50 Option	Nil take-up